In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 928

LITCHFIELD SECURITIES CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

In defining the amount of undistributed personal holding company income upon which the personal holding company tax is imposed, Section 545(b)(5) of the Internal Revenue Code of 1954 allows the deduction from the taxable income of a personal holding company of the excess of its net long-term capital gain for the taxable year over its net short-term capital loss for such year minus the income taxes attributable to such excess. The narrow issue here is whether the courts below correctly computed the attributable taxes.[1]

[1] The opinion of the district court is reported at 216 F. Supp. 801 (Pet. A-1–A-5); the opinion of the court of appeals is reported at 325 F. 2d 667 (Pet. A-6–A-15).

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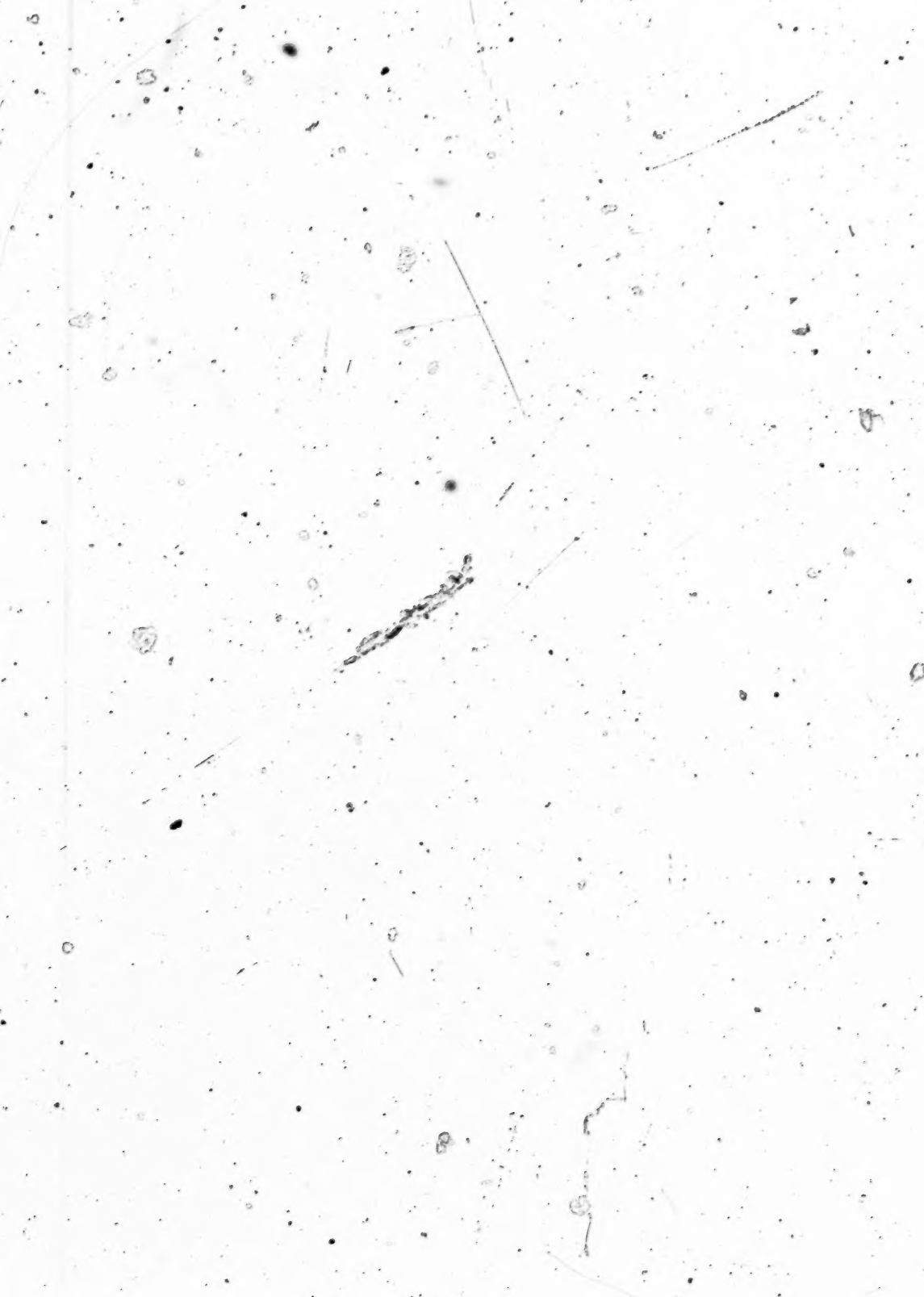

Section 545(b) provides as to attributable taxes:

> (b) Adjustments to Taxable Income.
>
> * * * * *
>
> (5) Long-term capital gains. * * * The taxes attributable to such excess [capital gain] shall be an amount equal to the difference between—
>
> (A) the taxes imposed by this subtitle (except the tax imposed by this part) for such year, and
>
> (B) such taxes computed for such year without including such excess [capital gain] in taxable income.
>
> * * * * * *

Since the parties agree that here (A) is $12,925.51, the sole question concerns the meaning of (B) (Pet. A–11). It is not disputed that the capital gain realized in 1957 was $48,410.14[2] (Pet. A–8, A–10). Taxpayer's position is that (B) is the amount the taxpayer would have paid had it not realized the capital gain; the government asserts that (B) means the tax which would have been imposed had the capital gain not been included in taxable income. Under taxpayer's construction of Section 545(b)(5)(B), the tax attributable to the capital gain is $1,641.81; under the government's construction, sustained by both courts below, this item is properly $12,102.54 (Pet. A–10, A–11). Since the effect of attributing a larger amount of income taxes to the taxpayer's capital gain resulted in diminishing the amount of the deduction allowed for long-term capital gain, the defi-

[2] Taxpayer here had $48,410.14 in capital gain and no short-term capital losses.

ciency of approximately $8,600 in personal holding company tax followed.

As explained in detail in the opinion below (Pet. A–11, A–12), taxpayer reads (B) to require recomputation of taxable income as if no capital gain had been realized, rather than mere reduction of the already ascertained taxable income by excluding the amount of the capital gain. The significance of the distinction is this: if taxpayer had realized no capital gain during the year it would not have been entitled to so large a dividends-received deduction in the computation of its taxable income. Under Section 243(a) of the 1954 Code a corporation may deduct 85 percent of the amount received as dividends from domestic corporations, but this general rule is qualified by Section 246(b)(1) which provide that such deduction may not exceed 85 percent of the taxable income (computed without regard to the dividends-received deduction). Stated otherwise, taxpayer's position is that to the extent that its net long-term capital gain enabled it to get the advantage of the full dividends-received deduction no taxes under Section 545(b)(5) were attributable to the gain, *i.e.*, the gain must be excluded from every phase of the computation of taxable income.

On the other hand, as the courts below held, subsection (B) is explicit. It does not say "such taxes as they would have been computed for such year if such excess [capital gain] had not existed" (see Pet. A–12). On the contrary, (B) reads "such taxes computed for such year without including such excess [capital gain] in taxable income," and, under Section

63(a), "taxable income" is gross income "minus the deductions allowed by this chapter." In fact, $212,432.41 of dividends-received deductions were "allowed" to the taxpayer (Pet. A–8, A–9, A–12). Section 545(b)(5)(B) provides, not for the recomputation of taxable income, but for the computation of taxes by deducting the excess capital gain from taxable income

Moreover, the legislative history of the 1954 Code set forth in the opinion of the court of appeals confirms the correctness of the decision below. (Pet. A–14–A–15). Under the 1939 Code as amended, the excess of net long-term capital gain over net short-term capital loss had been specifically excluded from the personal holding company tax, where the alternative provisions of Section 117(c)(1) applied. Since the capital gains tax on corporations was the same as that on individuals, the special personal holding company tax, which was designed to prevent individuals from escaping the tax rates on ordinary income, was not necessary. The 1939 Code also allowed deduction from personal holding company income of *all* federal income taxes paid. This meant that the holding company received a double deduction from the portion of net long-term capital gain less net short-term capital loss which was paid to the government under the capital gains tax.

In enacting the 1954 Code, the House sought to prevent this double benefit by excluding from the deduction for federal taxes in Section 545(b)(10) "the alternative capital-gains tax determined under Section 1201(a)(2)." At the same time, it continued

to allow deduction of the entire excess of net long-term capital gain over net short-term capital loss. H. Rep. No. 1337, 83d Cong., 2d Sess., p. 56. It is plain that the House bill would have compelled the result for which the government is contending. The Senate Finance Committee, however, changed the language to read as it now exists in Section 545(b)(5) of the 1954 Code. The need for this amendment arose from the fact that the alternative capital gains tax provided by Section 1201(a)(2) was applicable only when the tax computed thereunder was less than the tax otherwise computed; this tax would not be less when deductions exceeded income other than the excess of net long-term capital gains over net short-term capital losses. In such cases the House bill would have had the effect of still allowing a deduction of the entire amount of the capital gain plus the entire tax. S. Rep. No. 1622, 83d Cong., 2d Sess., p. 321. Thus, the Senate bill was intended to extend the House bill to a new area in order to prevent any possibility of a double deduction. It surely did not have the purpose of limiting the effect of the House bill where it already applied.

The decision of the court below is correct and its opinion well reasoned. The court merely applied the language of the statute in the light of its legislative history. The narrow question as to the meaning of Section 545(b)(5)(B) is without general importance; the statute has been in effect for almost ten years, and, in the only other case involving the question (*Delk Investment Corp.* v. *United States*, E.D. Mo., decided March 5, 1964), the taxpayer's theory was similarly rejected. Hence, while the Revenue Act of

1964, which broadens the application of the personal holding company tax to some extent, may result in an increase in the number of personal holding corporations, this by no means establishes that the question decided in this case will be recurrent. Certainly, in the absence of a conflict, there is no ground for further review by this Court.

CONCLUSION

We therefore respectfully submit that the petition for a writ of certiorari should be denied.

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